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IN THE

SUPREME COURT OF THE UNITED STATES

No. ~~250~~ 1965

STITZEL-WELLER DISTILLERY, a Kentucky Corporation, - - - - - - Petitioner,

versus

DEPARTMENT OF REVENUE, COMMONWEALTH OF KENTUCKY, - - Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF KENTUCKY.

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June 15, 1965.

WESTERFIELD-BONTE CO., INCORPORATED, LOUISVILLE, KY.

INDEX.

	PAGE
Citation of Opinion in Court Below	1
Grounds for Invoking Jurisdiction	2
Date of Judgment to be Reviewed	2
Date Rehearing Overruled	2
Order Staying Mandate	2
Statute Conferring Jurisdiction	2
Question Presented	2–3
Statement of Case	4–7
Reasons Relied On	7–21
Summary and Conclusion	21–23
Signature	23
Appendix	25–30
Majority Opinion	25–28
Dissenting Opinion	28–30

IN THE

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No. _____

STITZEL-WELLER DISTILLERY, a Kentucky Corporation, - - - - - - *Petitioner,*

v.

DEPARTMENT OF REVENUE, COMMONWEALTH OF KENTUCKY, - - - - - *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF KENTUCKY.

The petitioner, Stitzel-Weller Distillery, a Kentucky Corporation, prays that a writ of certiorari issue by this Court to review a final decision of the Court of Appeals of Kentucky, the highest appellate court of the Commonwealth of Kentucky, said decision having become final on March 26, 1965.

OPINION BELOW.

The opinion of the Court of Appeals of Kentucky was delivered initially on November 20, 1964, and a petition for rehearing was denied by said Court on March 26, 1965. The opinion appears in the appendix to this petition and is officially reported in 387 S. W. 2d 602.

JURISDICTION.

The jurisdiction of this Court is invoked by petitioner's contention that a taxing statute of the Commonwealth of Kentucky as applied to the facts in petitioner's case, is repugnant to Art. I Sec. 8, Cl. 3 and Art. I, Sec. 10, Cl. 2 of the Constitution of the United States.

The date and entry of the judgment sought to be reviewed is March 26, 1965.

On April 13, 1965 the Court of Appeals of Kentucky sustained petitioner's motion to stay the mandate of said Court; granted petitioner's motion that it be given until June 24, 1965 to prepare and file this petition for certiorari; and permitted petitioner to withdraw from the Clerk's office of the Court of Appeals, the entire original record for filing with the Clerk of this Court.

Jurisdiction is conferred on this Court under and pursuant to the provisions of Title 28 U.S.C.A., Sec. 1257(3).

QUESTION PRESENTED.

A Kentucky statute KRS 243.680(1) imposes a manufacturing tax at the rate of 10 cents per proof gallon, payable in advance of manufacture, on all distilled spirits produced in Kentucky.

Petitioner contends that said statute as applied to whiskey manufactured under a contract expressly for

export to a foreign country is repugnant to Art. I, Sec. 8, Cl. 3 (Commerce Clause) and Art. I, Sec. 10, Cl. 2 (Import-Export Clause) of the Constitution of the United States.

CONSTITUTIONAL PROVISIONS AND STATUTE INVOLVED.

Art. I, Sec. 8, Cl. 3 of the Constitution of the United States:

> "The Congress shall have power . . .;
>
> "To regulate commerce with foreign nations, and among the several states, and with Indian tribes."

Article I, Sec. 10, Cl. 2:

> "No state shall, without the consent of the Congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws: and the net proceeds of all duties and imposts laid by any State on imports or exports shall be for the use of the Treasury of the United States: and all such laws shall be subject to revision and control of the Congress."

Kentucky Revised Statutes Sec. 243.680(1):

> "No person shall manufacture distilled spirits in this State unless he first obtains from the Department a permit to engage in the business of manufacturing distilled spirits. At the time of the issuance of the permit he shall pay to the State a tax of ten cents for each proof gallon of distilled spirits for which the permit is issued."

STATEMENT OF THE CASE.

The essential facts of the case are contained in the following exchange of letters between petitioner and the Department of Revenue (R. 4-6, 21):

"July 26, 1963

Department of Revenue,
Frankfort, Kentucky.

Gentlemen:

"Our company has entered into negotiations to manufacture for Mr. Rudy Goes of Mexico City, Mexico, fifteen barrels of whiskey.

"The whiskey would be produced and stored in our Class Six U. S. Customs Bonded Warehouse located on the bonded premises of our distillery in Shively, Jefferson County, Kentucky.

"The U. S. Customs Bonded Class Six Warehouse, under the provisions of U. S. Internal Revenue Code Secs. 5521 et seq., is a manufacturing warehouse in which distilled spirits destined for export *and export only* may be manufactured and exported free of U. S. Internal Revenue taxes. The operator of such a warehouse must give a bond (U. S. Customs Form 7571) with surety, guaranteeing that distilled spirits manufactured in the Class Six warehouse, once having been exported, will never be re-introduced into the domestic market without payment of all internal revenue taxes. In addition, the barrels will be stenciled, marked or branded in accordance with Federal Distilled Spirits Plants regulations Part 201 (Sec. 201.524) and Federal Export Regulation Part 252 (Sec.

252.103) so that the merchandise may be identified at all times as an 'export.'

"Our proposed contract with Mr. Goes is based on a fixed price per proof gallon calculated on a cost plus basis. It is imperative, therefore, that we know prior to manufacture whether the Kentucky Department of Revenue will require the payment of the ten cent (10¢) per gallon tax on the manufacture of these distilled spirits under the provision of K.R.S. 243.680.

"We take the view that this operation is not subject to the tax since the production is exclusively for export and that both the Federal Government and the states are forbidden by the U. S. Constitution to levy any tax on exports. We therefore request that you issue us a tax free permit for the production of fifteen barrels of whiskey for export to our customer Rudy Goes whose address is M. C. Saavedra No. 23, Mexico 17, D. F., Mexico.

"Should you require it, we are willing to execute a bond similar in terms to that referred to above running to the Commonwealth of Kentucky and guaranteeing that the whiskey in question will not be introduced into the domestic market.

"In view of the fact that we cannot conclude the contract and begin production for our customer without first knowing whether you will issue the tax free permit, the favor of a reply is urgently requested before the 31st day of July, 1963, as our customer wants to start building a continuity of maturing inventories as early as possible.

"Since our contract has been computed on a close margin of profit, the exaction of the manu-

facturing tax by Kentucky will undoubtedly mean the loss of this export business since the ten cent per gallon tax amounts to approximately seventeen cents (17¢) by the time the whiskey has matured. This is by reason of the fact that during the period of storage a substantial portion of the original production is lost through evaporation plus the interest accumulation on the original tax payment for a period from 4 to 6 years.

Yours very truly,

Signed: C. K. McClure, Secretary-Treasurer,
Stitzel-Weller Distillery, Inc."

"August 7, 1963

Stitzel-Weller Distiller,
Station D,
Louisville, Kentucky,

Attention: C. K. McClure,
Secretary & Treasurer.

Gentlemen:

"We are in receipt of your letter, dated July 26, 1963, requesting the issuance of a tax free permit for the production of fifteen barrels of whiskey for export to Rudy Goes, M. C. Saavedra No. 23, Mexico 17, D. F. Mexico.

"In view of the provisions of KRS 243.680(1), which states that no person shall manufacture distilled spirits in this state unless he first obtains from the department a permit to engage in the business of manufacturing distilled spirits and at the time of the issuance of the permit he shall pay

to the state a tax of ten cents for each proof gallon of distilled spirits for which the permit is issued, your request must be denied.

Sincerely,

(s) Froman Ratcliff,
Supervisor,
Miscellaneous Tax Section."

REASONS RELIED ON FOR ALLOWANCE OF THE WRIT.

Part I.

The Kentucky Court of Appeals has decided this case in a way that is not in accord with the following decisions of this Court: McGoldrick v. Gulf Oil Corp., 309 U. S. 414, 84 L. Ed. 840, 60 S. Ct. 664; Richfield Oil Corp. v. State Board of Equalization, 329 U. S. 69, 91 L. Ed. 80, 67 S. Ct. 156.*

Part II.

The majority opinion in this case by the Kentucky Court of Appeals is based on three erroneous assumptions of fact and a false conclusion arising therefrom.

1. The first erroneous assumption was "that the whiskey will be manufactured and 'drawn off' before it is placed in bond." As will presently be pointed out the entire operation outlined in the complaint (R. 1-9) is to be conducted "in bond."

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*Cf. Hostetter v. Idlewild Bon Voyage Liquor Corp. ____ U. S. ____, 12 L. ed. 2d 350, 84 S. Ct. ____; Department of Alcoholic Beverage Control v. Ammex Warehouse Co., ____ U. S. ____ 12 L. ed. 2d 743, 84 S. Ct. ____.

2. The second erroneous assumption was that because the stipulated facts (R. 26-27) do not show that the whiskey will be produced in a bonded manufacturing warehouse it is not entitled to immunity from taxation., As will be presently pointed out whiskey cannot be produced in a bonded manufacturing warehouse but can only be produced in a "distilled spirits plant."

3. The third erroneous assumption was the Court's statement that the stipulated facts "show that the whiskey will be manufactured and 'drawn off' before it is placed in such bond." This is not so. Not only will the whiskey be produced "in bond" but, as hereinafter pointed out must be produced in bond and must remain in bond continuously until it has been exported.

4. The false conclusion of the majority opinion based on the three foregoing erroneous assumptions, was that the trial judge "*assumed* that the whiskey in the instant case would be exported subject to the strict control of the federal government." The trial judge "assumed" no such thing. He correctly concluded that the applicable federal statutes and regulations were enacted for the express purpose of establishing an "in bond" procedure which if followed, was intended by Congress to grant immunity from taxation—both federal and state. The procedure provides a statutory approved method of segregating from the general mass of taxable property, a special class of property destined for export, and is designed to overcome the question which has given the courts the most trouble; viz., the

determination of when goods intended for export have actually entered "the export stream" so as to receive the tax immunity which the Constitution clearly provides.

The Kentucky Court of Appeals failed to grasp this point. It also failed to recognize, that under the statutory procedures presently to be examined, that the entire operation, from the time the grain is brought onto the distillery premises for distillation until the final act of exportation of the whiskey, is all conducted "in bond," *i.e.* under the strict supervision of officers of the Internal Revenue and Customs Services.

Part III.

Under federal law whiskey cannot be legally made anywhere except in a licensed "distilled spirits plant" (27 U.S.C. 203).

Sections 5171-5315 of Title 26 of the U. S. Code set forth in detail the laws which Congress has enacted governing the manner in which distilled spirits plants must qualify and be operated. The end purpose of all of these provisions is to insure payment of the federal excise tax of $10.50 per proof gallon.*

Before a person can commence business as a distiller or bonded warehouseman he must furnish a bond con-

*26 U.S.C. 50.01(a)(1):

"There is hereby imposed on all distilled spirits in bond . . . an internal revenue tax at the rate of $10.50 on each proof gallon . . .

"(b) The tax shall attach to distilled spirits as soon as this substance is in existence as such . . ."

ditioned that he will faithfully comply with all laws including the payment of all taxes (26 U.S.C. 5173).*

Other bonds required of a distiller or warehouseman are withdrawal bonds (Sec. 5174) and Export Bonds (Sec. 5175).

The conditions of all bonds are essentially the same; viz., that the distiller or warehouseman will faithfully comply with all laws relating to his business including the payment of all internal revenue taxes. Hence comes the expression "in bond" meaning that the operation being conducted with respect to the distilled spirits in question is being conducted prior to the payment of the federal excise tax, and while the distiller or warehouseman is still bound for the tax under the conditions of one of the bonds above referred to.

All distilled spirits are therefore "in bond" from the time they come into existence and must so remain until the internal revenue tax has been paid or until withdrawn under some statutory provision to which Congress has granted a tax free status.

Withdrawal for export is one instance in which Congress has granted tax immunity. We proceed now to point out the laws and regulations by which this has been accomplished.

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*Hereinafter whenever sections of Federal statutes are cited without reference to Title, they will all relate to Title 26 U.S.C. (the Internal Revenue Code).

Part IV.

We have seen (*supra*) that whiskey can only be legally made in a "distilled spirits plant" duly licensed and qualified under federal laws and regulations.

We have also noted (*supra*) the sections of the Internal Revenue Code governing the qualification and operation of distilled spirits plants.

Section 7801 of the Internal Revenue Code provides that the administration and enforcement of all of these and other provisions of the Code shall be performed by or under the supervision of the Secretary of the Treasury.

All of the Code sections herein to be examined, give "the Secretary or his delegate" the power to make regulations by way of implementation of the statutory provisions.

Section 7701 of the Code defines "Secretary" to mean Secretary of the Treasury.

The same Code section defines "delegate" to mean any officer, employee or agency of the Treasury Department duly authorized by the Secretary (directly or indirectly by one or more re-delegations of authority) to perform the functions mentioned or described in the context.

The operations described in the Complaint (R. 1-9) all take place (a) in a distilled spirits plant, (b) then by transfer in bond to (c) a Customs Bonded Warehouse.

The operations will be under the continuous supervision of (a) U. S. Internal Revenue officers and (b) U. S. Customs officials.

Section 7802 of the Internal Revenue Code provides for the appointment by the President of a Commissioner of Internal Revenue who "shall have such duties and powers as may be prescribed by the Secretary."

Under the authority given him under the Code the Secretary has delegated to the Commissioner of Internal Revenue complete authority to enforce the provision (*supra*) governing the production, warehousing and bottling of distilled spirits and the collection of the excise tax thereon. These functions are centered in a division of the Treasury Department known as the Alcohol and Tobacco Tax Division which is in charge of an Assistant Commissioner of Internal Revenue.

Title 5 U.S.C. Section 281 creates a Bureau of Customs, provides for a Commissioner of Customs to be appointed by the Secretary of the Treasury and to head the Bureau. Under this section it is also provided (281 (a) (c)) that the personnel of the Bureau of Customs shall perform such duties as the Secretary of the Treasury shall prescribe.

We come next to examine the pertinent provisions of two sets of regulations which the Secretary of the Treasury has adopted pursuant to the authority to do so contained in the Code.

One of these is known as Federal Distilled Spirits Plants Regulations and the other as Federal Exportation of Liquors Regulations.

We will discuss these in the above order.

Federal Distilled Spirits Plants Regulations, 26 Code of Federal Regulations Part 201 U. S. Treasury Department Internal Revenue Service (approved June

24, 1960; 25 F. R. 6052 June 30, 1960; effective July 1, 1960. Codified in Title 26 Code of Federal Regulations (1954) Part 201, Distilled Spirits Plants. Authority: Secs. 201.1 to 201.635 issued under Sec. 7805.68 A Stat. 917; 26 U.S.C. [I.R.C.] 7805. These regulations implement Code Secs. 5171-5315 noted *supra*).

Sec. 201.11 contains definitions of the various terms to be used in the regulations.

Under this section, "distillery" is defined as "a distilled spirits plant, or part thereof, as described in the application for registration, authorized for the production of spirits."

This same section defines "bonded premises" as follows:

> "The premises of a distilled spirits plant, or part thereof, described in the application for registration, on which, operations relating to the production, storage, denaturation or bottling of distilled spirits prior to payment or determination of tax are authorized to be conducted."

From the foregoing definitions it is clear that all facets of the operations of the production and storage of spirits prior to the payment of the Federal excise tax thereon, must be conducted on "bonded premises." They cannot legally be conducted anywhere else.

Operations conducted on "bonded premises" are said to be conducted "in bond," the term in bond being defined in the regulations as follows:

> "In bond . . .
>
> "When used in respect to spirits (including denatured spirits) refers to such spirits possessed

under bond to secure the payment of the internal revenue tax imposed by Sec. 5001 (a) (2) I.R.C. and in respect to which the tax imposed by such section has not been determined as provided in this part *and includes such spirits on the bonded premises of a distilled spirits plant, in transit between such premises*, in transit from customs custody to such premises and such spirits withdrawn without payment of the tax under Sec. 5214 I.R.C. and from which relief of liability has not yet occurred under the provisions of Section 5005 (c) (2) I.R.C. (26) (Code of Federal Regulations Part 201 Sub-part B. Section 201.11 Definition." (Our emphasis.)

The code section 5214 referred to in the foregoing Regulation reads as follows:

"Distilled spirits on which the internal revenue tax has not been paid or determined may, subject to such regulations as the Secretary or his delegate* shall prescribe, be withdrawn from the bonded premises of any distilled spirits plant in approved containers . . .

"(6) without payment of tax for transfer to manufacturing bonded warehouses as authorized by Section 5522 (a)."

Code Section 5522 (a) referred to in Section 5214 (*supra*) reads as follows:

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*"Secretary—the term 'Secretary' means the Secretary of the Treasury. Delegate—the term 'Secretary or his delegate' means the Secretary of the Treasury, or any officer, employee or agency of the Treasury Department duly authorized by the Secretary (directly or indirectly by one of more delegations of authority) to perform the function mentioned or described in the context." 26 U.S.C., Sec. 7701.

"Under such regulations and requirements as to stamps, bonds, and other security as shall be prescribed by the Secretary or his delegate, any *manufacturer of . . . liquors for export,* manufacturing* the same in duly constituted manufacturing bonded warehouse, shall be authorized to withdraw from the bonded premises of any distilled spirits plant, so much distilled spirits as he may require for such purpose without payment of the internal revenue tax thereon." (Our emphasis.)

From the foregoing discussion it will be noted that the following facts, are fully substantiated as matters of law, because they are contained in Federal Statutes and Regulations and hence are matters of which the Court will take judicial notice.

1. Whiskey must and can only be legally produced in a "distilled spirits plant"; and,

(a) Such a plant must be located on bonded premises, and,

(b) That whiskey so produced will have been produced "in bond."

2. The transfer of whiskey from the distilled spirits plant to the manufacturing bonded warehouse is a transfer "in bond."†

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*The term "manufacturing" as here used, and as later will be more fully explained, does not refer to "distillation" but *only* to rectification, reduction in proof, bottling and packaging.

†"Distilled spirits on which the internal revenue tax has not been paid or determined as authorized by law, may under such regulations as the Secretary or his delegate prescribe, be transferred in bond between bonded premises in any approved container" (I.R.C., Sec. 5212).

3. That whiskey in a manufacturing bonded warehouse established under Sec. 5521 of the Internal Revenue Code is "in bond."

Thus we see that the entire export procedure described in the Complaint and stipulation of facts is conducted "in bond." It is required to be so under Federal laws and regulations.

Another misconception, and apparently one on which the majority opinion was also based, is found in this language of the opinion:

> "In the instant case the stipulated facts nowhere state that this whiskey will be produced in a bonded manufacturing warehouse."

The foregoing is a perfectly true statement. The stipulated facts did not and could have so stated because the production (distillation) of whiskey in a class six manufacturing bonded warehouse is expressly forbidden by law.

Sec. 1311 of Title 19 of the U.S.C. reads in part:

> "The manufacture of distilled spirits from grain, starch, molasses or sugar, including dilutions of them or either of them shall not be permitted in such manufacturing warehouses."

The majority of the Court was evidently confused as to the kind of "manufacturing" contemplated and authorized with respect to distilled spirits deposited in a class six manufacturing bonded warehouse. The character of the "manufacturing" is set forth in Section 5521 of the Internal Revenue Code which provides in part:

> "Distilled spirits and wine which are *rectified* in a manufacturing bonded warehouse, class 6, and distilled spirits which are *reduced in proof and bottled or packaged* in such warehouse shall be deemed to have been manufactured within the meaning of Section 311 of the Tariff Act of 1930 (19 U.S.C. 1311)." (Our emphasis.)

The foregoing will serve to clarify the meaning of "manufacturing" to take place in the bonded warehouse with respect to the whiskey in the case at bar. It will be reduced in proof, bottled and cased, prior to exportation (see R., p. 3). No other "manufacturing" can or will be done in such a warehouse so far as whiskey is concerned.

Section 5521 of the Internal Revenue Code makes special provision for the establishment of manufacturing bonded warehouses "similarly constructed to those known and designated in Treasury regulations as bonded warehouses, class six" in which liquors can be "manufactured" (*i.e.,* rectified, reduced in proof and bottled or packaged) for export without payment of the internal revenue tax.

Before liquors may be entered in a manufacturing bonded warehouse Section 5521 I.R.C. provides that the manufacturer "shall first give satisfactory bonds to the Secretary or his delegate for the faithful observance of all the provisions of the law and regulations."

It will be noted that in the Complaint (R., p. 6) petitioner offered to execute a similar bond (should the Court require it) to the Commonwealth of Kentucky, guaranteeing that these barrels of whiskey with

identifying symbols and markings would be produced, warehoused, bottled, packaged and exported as outlined in the Complaint. The entire procedure as demonstrated by the provisions of the Federal Internal Revenue Code and Regulations heretofore cited, will and *must* be conducted "in bond." The Federal code sections and regulations cited (*supra*) do not permit any interim or break in the "in bond" status of the whiskey from the time the grain is brought onto the "bonded premises" until the final act of exportation takes place.

The majority opinion cites with approval McGoldrick v. Gulf Oil Corp., 309 U. S. 414, 84 L. Ed. 840, 60 S. Ct. 664, to the effect that: "When goods are under Federal supervision from the inception of their manufacture until delivery to a common carrier for export they are not subject to State taxation."

In the case at bar, the whiskey in question fully meets this test, and therefore qualifies as a tax free export under the McGoldrick decision.

The majority opinion also cites with apparent approval, Richfield Oil Corp. v. State Board of Equalization, 329 U. S. 69, 91 L. Ed. 80, 67 S. Ct. 156, to the effect that, "if the incidence which gives rise to the accrual of the tax is a step in the export process, the levy is unconsitutional."

We concur in this view.

What is the incidence which gives rise to the accrual of the tax in the case at bar? It is not the act of production?

The statute (K.R.S. 243.680(1)) makes it perfectly plain that no person shall manufacture (produce) distilled spirits without first obtaining a permit for which he shall pay at the rate of 10¢ per proof gallon for each gallon for which the permit is issued. If the spirits are not manufactured (produced) then of course there can be no tax liability. The incidence which gives rise to the tax liability is therefore the act of production, which as we have seen *supra* must, and can only take place under strict and continuous government supervision (in bond) from start to finish.

In this respect the incidence which gives rise to the Federal excise tax liability of $10.50 per gallon is exactly the same as that of the Kentucky manufacturing tax. In both instances it is the act of production which gives rise to the liability.*

The Federal statutes and regulations cited *supra* were adopted for the express purpose of giving tax free status to distilled spirits produced, warehoused, packaged and exported in accordance therewith. The whiskey in the case at bar if produced, warehoused, packaged and exported as outlined in the Complaint will be free of Federal tax. It follows that it is also free of State tax because the Constitution forbids both the Federal government and the states to tax exports and the same rules under the decided Supreme Court cases therefore apply to both forms of taxation.

The act of "exportation" which gives rise to the immunity from Federal taxation is thus defined in Federal Exportation Regulations:

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*26 U.S.C. Sec. 5001(b) provides: "The tax shall attach to distilled spirits as soon as this substance is in existence as such . . ."

> "Exportation. A severance of goods from the mass of things belonging to the United States with the intention of uniting them to the mass of things belonging to some foreign country." 26 Code of Federal Regulations, Part 252, Sec. 252.11 Definitions.

Section 252.91 of Sub-part E of the same Regulations provide:

> "Distilled spirits on which the internal revenue tax has not been paid or determined, may subject to this part, be withdrawn from the bonded premises of a distilled spirits plant without payment of the tax for:
>
> "(a) Exportation
>
> "(d) Transportation to and deposit in a manufacturing bonded warehouse. All such withdrawals shall be made under the applicable bond prescribed in Sub-part D of this part."

The majority opinion cites respondent's contention "that since K.R.S. 243.680 (1) has been held to be an occupational tax, its incidence is on the privilege of manufacturing which precedes the time when the tax immunity of the Federal Constitution attaches." (It is not clear to us whether the majority opinion adopts respondent's view of the matter. If so this is also an error.)

This identical argument was advanced by respondent in the Beam case,* viz., that the ten cent import tax in that case was an occupational tax, its incidence being

*Department of Revenue v. James B. Beam Distilling Co., ____ U. S. ____, 12 L. Ed. 2d 362, 84 S. Ct. ____ (June 1, 1964).

on the privilege of importing which preceded actual importation.

This contention was rejected by the Court. In fact the contention is as old as Brown v. Maryland (1828), 12 Wheat 419, 25 U. S. 419, 6 L. Ed. 678, the first Supreme Court case to deal with the Import-Export clause. The Brown case involved an occupational license tax levied on an importer. Chief Justice Marshall, who delivered the opinion, pointed out that an occupational tax was in fact a tax on the product itself and therefore unconstitutional, and his ruling in this regard has been adhered to ever since. It follows that K.R.S. 243.680(1) (an occupational tax on the manufacturer) is unconstitutional as to goods manufactured for export, because Article I, Sec. 10, Cl. 2 forbids a state to tax either imports or exports.

SUMMARY AND CONCLUSION.

1. The Kentucky Court of Appeals came to a wrong decision in this case because of these erroneous assumptions:

(a) That in order to receive tax immunity as an export the whiskey has to be produced in a manufacturing bonded warehouse. (As we have pointed out, this is not possible.)

(b) That the whiskey in question "will be 'drawn off' before it is placed in bond." (As we have pointed out this is not true. The entire operation from the time the grain is brought on the bonded premises to the final act of exportation, all must be conducted "in bond" under the strict supervision of Federal offi-

cers under applicable provisions of the Internal Revenue Code and Regulations.).

2. The majority opinion cites with approval McGoldrick v. Gulf Oil Corp. (*supra*) to the effect that "when goods are under Federal supervision from the inception of their manufacture until delivery to a common carrier for export, they are not subject to State taxation." (There is no room for the slightest doubt that the whiskey in the case at bar fully meets this test. The cited statutes and regulations make it mandatory that every step of the process be conducted "in bond" in the presence of Federal Internal Revenue and Customs officers.)

3. The majority opinion also cites with approval the case of Richfield Oil Corp. v. State Board of Equalization (*supra*) to the effect that "if the incidence of the tax is a step in the export process, the levy is unconstitutional." (The incidence of the Kentucky tax is the act of production which as pointed previously must be conducted under Federal supervision and constitutes the first step in the export process, because the whiskey will not be produced except for this purpose.)

4. There can be no question but what the whiskey destined for export would be granted exemption from the Federal excise tax under the procedures outlined in the Complaint, because these procedures were fashioned by Congress for the very purpose of granting the exemption to which all true exports are entitled. Congress having declared that distilled spirits so produced, stored, packaged and shipped to a foreign country shall

not be subject to the Federal Internal Revenue tax, it follows that such spirits are also exempt from State taxation under the decided cases cited *supra*.

Respectfully submitted,

MILLARD COX,
1021-1023 Ky. Home Life Bldg.,
Louisville, Kentucky 40202,
Attorney for Petitioner.

June 15, 1965

APPENDIX

COURT OF APPEALS OF KENTUCKY

RENDERED: NOVEMBER 20, 1964

DEPARTMENT OF REVENUE, COMMONWEALTH OF KENTUCKY, - - - - - - *Appellant,*

v.

STITZEL-WELLER DISTILLERY (a Kentucky Corporation), - - - - - - - *Appellee.*

Appeal from the Franklin Circuit Court,
Honorable Charles M. Allen, Special Judge.

OPINION OF THE COURT BY COMMISSIONER WADDILL—REVERSING.

In this action for a declaration of rights we are asked to determine whether the tax imposed by KRS 243.680(1) is applicable to the manufacture of distilled spirits to be exported. This statute provides:

> "No person shall manufacture distilled spirits in this state unless he first obtains from the Department a permit to engage in the business of manufacturing distilled spirits. At the time of the issuance of the permit he shall pay to the state a tax of ten cents for each proof gallon of distilled spirits for which the permit is issued."

The stipulation of facts which the parties filed shows that: The appellee, a licensed manufacturer of distilled spirits, is negotiating a contract to manufacture fifteen (15) barrels of bourbon whiskey for a customer in Mexico; that this whiskey, when manufactured, will be drawn off into barrels identified for export in compliance with 26 CFR

252.013; that the whiskey when manufactured will be entered into appellee's Class 6 U. S. Customs Bonded Manufacturing Warehouse (26 U.S.C. Sec. 5521 (1959)), and that appellee is unable to complete its contract negotiations since it is unable to determine whether it is liable for payment of this tax.

The trial judge recognized that Congress had established a scheme whereby certain products, such as whiskey, may be relieved of local taxes so as to meet foreign competition. He assumed that the whiskey in the instant case would be exported subject to the strict control of the federal government from the time of production until exportation, and he concluded the levy of this tax would be an infringement of the congressional regulation of commerce under the Federal Constitution. Judgment was accordingly entered.

Appellant contends that since KRS 243.680(1) has been held to be an occupational tax (Brown-Forman Distillers Corp. v. Commonwealth of Kentucky, Ky., 346 S. W. 2d 752), its incidence is on the privilege of manufacturing which precedes the time when the tax immunity of the Federal Constitution attaches. Appellee asserts that this whiskey will be committed to be exported from the time it is produced and may not be constitutionally taxed by Kentucky.

The applicable test was enunciated in Empresa Siderurgica S.A. v. County of Merced, 337 U. S. 154, 93 L. Ed. 1276, 69 S. Ct. 995, as follows:

> "* * * The tax immunity runs to the process of exportation and the transactions and documents embraced in it. * * * It is the entrance of the articles into the export stream that marks the start of the process of exportation. Then there is certainty that the goods are headed for their foreign destination and will not be diverted to domestic use. Nothing less will suffice."

When goods are under federal supervision from the inception of their manufacture until delivery to a common carrier for export they are not subject to state taxation (McGoldrick v. Gulf Oil Corp., 309 U. S. 414, 84 L. Ed. 840, 60 S. Ct. 664) and if the incidence which gives rise to the accrual of the tax is a step in the export process, the levy is unconstitutional (Richfield Oil Corp. v. State Board of Equalization, 329 U. S. 69, 91 L. Ed. 80, 67 S. Ct. 156).

In the instant case the stipulated facts nowhere state that this whiskey will be produced in a bonded manufacturing warehouse. Moreover they show that the whiskey will be manufactured and "drawn off" before it is placed in such bond. We conclude that this whiskey will not be committed with certainty to the stream of exportation until it has been segregated from a common mass of distilled spirits and placed under federal supervision in a Class 6 Bonded Warehouse. Therefore the incidence of the tax imposed by KRS 243.680(1) has not been shown to be a step in the process of exportation and the tax may be collected from appellee.

The judgment is reversed with directions to enter a new one approving the collection of the tax imposed by KRS 243.680(1).

Chief Justice Milliken and Justice Moremen dissenting.

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COURT OF APPEALS OF KENTUCKY

DEPARTMENT OF REVENUE, COMMONWEALTH OF KENTUCKY, - - - - - - *Appellant,*

v.

STITZEL-WELLER DISTILLERY (a Kentucky Corporation), - - - - - - - - *Appellee.*

Appeal from Franklin Circuit Court,
Hon. Charles M. Allen, Special Judge.

JUSTICE MOREMEN WITH WHOM CHIEF JUSTICE MILLIKEN JOINS DISSENTING.

The opinion suggests that the only whiskey which may be exempt from the production tax under subsection (1) of KRS 243.680 must be produced and manufactured within the physical boundary and confines of a Class 6 U. S. Customs Bonded Manufacturing Warehouse. (I doubt very much if any distiller within this state has a still in a Class 6 Warehouse or a Bonded Warehouse of any nature; the still house is usually in a separate building.) The opinion, however, holds that if the whiskey is not produced under such unusual circumstances, it has not been committed with certainty to the stream of exportation. I cannot understand why the particular spot of production has such importance. Under subsection (2) of § 5002, Title 26 U. S. C. it is required that the entire premises be bonded, and the bonded premises are subjected to rigid federal control.

It appears that the most important thing should concern whether a distiller has committed with certainty 15 barrels of whiskey to specific export trade—otherwise we are concerned only with security measures. There is no more likelihood that goods will be diverted to domestic use from a bonded Class 6 Warehouse than from the bonded premises of the entire unit which it also highly policed. It will be remembered that as soon as whiskey is drawn off, it is placed in specially marked barrels and immediately taken to the Class 6 Warehouse. As soon as it comes into being as raw spirits, it is marked and on its way to a foreign land.

I believe that the covenant and promise of the distiller has greater significance than the physical property of the plant. It is plain from the letter of intent which is made a part of the complaint that appellee requested the issuance of a tax free permit from the state for the manufacture of fifteen barrels of whiskey. It follows that when that fifteen barrels of whiskey are produced and come into being they are immediately committed to specific export trade under the terms of the letter. If there is any diversion thereafter, there are sufficient sanctions, both state and federal, which may be applied. It is a matter of common knowledge—at least in this state—that the manufacture and storage of distilled spirits are subject to strict control of the federal government during the period of its manufacture and transportation to the warehouses and, for that matter, thereafter. In addition, under 26 U. S. C. § 5521 et sequitur, the manufacturer must execute satisfactory bonds for the faithful observance of all provisions of federal law and regulations promulgated thereunder.

It is apparent from the facts stated in the majority opinion that the distiller has covenanted to comply with all laws and regulations as to identification and storage. The only flaw the majority opinion finds with the proposed plan

is that the entire manufacturing process did not take place within a Class 6 Warehouse. Such a holding, I believe, is beyond the spirit and intent of the constitution and federal statutes and regulations. I am convinced that under the facts the 15 barrels of whiskey which will be ultimately produced under a permit granted under subsection (1) of 243.680 (whether tax free or not) are definitely committed to exportation from the beginning of the distillation process.

We, therefore, respectfully dissent.